CANADA

NATIONAL ENERGY BOARD

REASONS FOR DECISION

In the Matter of Phase IV(b) of a Public Hearing
Respecting Tariffs and Tolls to be Charged,
the Financing of the Pipeline, and Other Related Matters
of

FOOTHILLS PIPE LINES (YUKON) LTD.

MAY 1980

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May 1980

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NATIONAL ENERGY BOARD

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder, and the Northern Pipeline Act; and

AND IN THE MATTER OF a public hearing respecting tariffs and tolls to be charged by Foothills Pipe Lines (Yukon) Ltd. (hereinafter referred to as "Foothills (Yukon)"), the financing of the pipeline and other related matters. File No. 1510-2-2

Phase IV (a)

HEARD AT Ottawa, Ontario on 5 and 6 May 1980

BEFORE:

C.G. Edge	Presiding Member
L.M. Thur	Member
R.B. Horner	Member

APPEARANCES:

John Lutes C.W. Sanderson	) Foothills Pipe Lines (Yukon) Ltd.)
E.B. McDougall	) Northwest Alaskan Pipeline Company
L.H. Pilon	) TransCanada PipeLines Limited
Stephen Wakefield	) ANB Gas Company) United Gas Pipeline Company
E.B. McDougall	) Northwest Pipeline Corporation
W.T. Houston	) Tennessee Gas Pipeline Division of) Tenneco Inc.
G.A. Connell	) Gulf Canada Resources Inc.
J.H. Farrell	) Hiram Walker-Consumers'-Home Ltd.
A. Butler Mary Blain	) Union Gas Limited)
M. McDill	) Canadian Petroleum Association
A.E. Potter	) Independent Petroleum Association) of Canada
K.J. MacDonald	) National Energy Board

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ABBREVIATIONS AND DEFINITIONS

AGTL	- The Alberta Gas Trunk Line Company Limited
ANG	- Alberta Natural Gas Company Ltd.
Board or N.E.B.	- The National Energy Board
Canada-U.S. Agreement	- Agreement between Canada and the United States of America on Principles Applicable to a Northern Natural Gas Pipeline, dated September 20, 1977.
CPA	- Canadian Petroleum Association
Eastern Leg (in Canada)	- At a point just south of Caroline, Alberta, the pipeline will bifurcate. The "eastern leg" will proceed in a southeasterly direction to the Alberta - Saskatchewan border near Empress, Alberta and then to the Canada - United States border near Monchy, Saskatchewan where it will connect with the facilities of Northern Border Pipeline Company (the United States eastern leg).
F.E.R.C.	- The United States Federal Energy Regulatory Commission, formerly the Federal Power Commission.
Foothills (Yukon)	- Foothills Pipe Lines (Yukon) Ltd. is the parent company responsible for the Canadian portion of the Alaska Highway Gas Pipeline Project. Foothills (Yukon) is currently sponsored 50 per cent each by AGTL and Westcoast. The ownership of the pipeline is segmented into six federally-incorporated subsidiaries.
Foothills (South Yukon)	- Foothills Pipe Lines (South Yukon) Ltd., owned one hundred (100) per cent by Foothills (Yukon), will own, operate and manage the approximately eight hundred and thirty (830) kilometres of pipeline through the Southern Yukon.
Foothills (North B.C.)	- Foothills Pipe Lines (North B.C.) Ltd. owned fifty-one (51) per cent by Foothills (Yukon) and forty-nine (49) per cent by Westcoast, will own, operate and manage the the approximately seven hundred and ten (710) kilometres of pipeline through northern British Columbia.

Foothills (Alta.)	-	Foothills Pipe Lines (Alta.) Ltd. owned fifty-one (51) per cent by Foothills (Yukon) and forty-nine (49) per cent by AGTL, will own, operate and manage the approximately thirteen hundred (1300) kilometres of pipeline through Alberta.
Foothills (Sask.)	-	Foothills Pipe Lines (Sask.) Ltd., owned one hundred (100) per cent by Foothills (Yukon), will own, operate and manage the approximately two hundred and sixty (260) kilometres of pipeline in Saskatchewan.
Foothills (South B.C.)	-	Foothills Pipe Lines (South B.C.) Ltd., owned fifty-one (51) per cent by Foothills (Yukon) and forty-nine (49) per cent by Alberta Natural Gas Company Ltd., will own, operate and manage the approximately one hundred and seventy (170) kilometres of pipeline through southern British Columbia.
Foothills (North Yukon)	-	Foothills Pipe Lines (North Yukon) Ltd., owned one hundred (100) per cent by Foothills (Yukon), will own, operate and manage the approximately eleven hundred and eighty (1180) kilometres of pipeline through the Yukon and Northwest Territories to connect Delta gas to Whitehorse along the Dempster Highway.
Foothills Pipe Lines Ltd.		A company owned 70 per cent by The Alberta Gas Trunk Line Company Limited and 30 per cent by Westcoast Transmission Company Limited. The Company's activities related primarily to the Mackenzie Valley pipeline project.
Northern Border Pipeline Company	-	Northern Border (the U.S. eastern leg) is a natural gas pipeline company engaged in transporting gas from an interconnection with the pipeline facilities of Foothills (Sask.) at the international boundary near Monchy, Saskatchewan to points of delivery to the east on Northern border's system.

Northern Pipeline Hearing	-	The hearings held by the National Energy Board during 1976 and 1977 that resulted in a publication of the Board entitled "Reasons for Decision, Northern Pipelines", dated June, 1977, and which led to a certificate of public convenience and necessity, by virtue of the Northern Pipeline Act, to the subsidiaries of Foothills Pipe Lines (Yukon) Ltd.
Pan-Alberta	-	Pan-Alberta Gas Ltd.
Prebuild Facilities and Prebuilding	-	The facilities of the Foothills (Yukon) pipeline to be built to transmit for export natural gas of Canadian origin before the rest of the pipeline is placed in service for the transmission of Alaska gas.
P.G.T.	-	Pacific Gas Transmission Company
P.G. & E.	-	Pacific Gas and Electric Company
TransCanada	-	TransCanada PipeLines Limited
Westcoast	-	Westcoast Transmission Company Limited
Western Leg (in Canada)	-	At a point just south of Caroline, Alberta, the pipeline will bifurcate. The "western leg" will proceed southward to Coleman on the Alberta - British Columbia border and then in a southwesterly direction to the Canada - United States border near Kingsgate, B.C., where it will connect with the facilities of Pacific Gas Transmission Company (the United States western leg).
Zones 1 to 11	-	The zones for the Northern Pipeline and the Dempster Line in Canada, described as follows in the Canada - U.S. Agreement:

Zone 1 Foothills Pipe Lines (South Yukon) Ltd.

Alaska Boundary to point of interconnection with the Dempster Line at or near Whitehorse.

Zone 2 Foothills Pipe Lines (South Yukon) Ltd.

Whitehorse to Watson Lake.

Zone 3 Foothills Pipe Lines (North B.C.) Ltd.

Watson Lake to point of interconnection with Westcoast's main pipeline near Fort Nelson.

Zone 4 Foothills Pipe Lines (North B.C.) Ltd.

Point of interconnection with Westcoast's main pipeline near Fort Nelson to the Alberta - B.C. border.

Zone 5 Foothills Pipe Lines (Alta.) Ltd.

Alberta - B.C. border to point of bifurcation near Caroline, Alberta.

Zone 6 Foothills Pipe Lines (Alta.) Ltd.

Caroline, Alta. to Alberta - Saskatchewan border near Empress.

Zone 7 Foothills Pipe Lines (Alta.) Ltd.

Caroline to Alberta - B.C. border near Coleman.

Zone 8 Foothills Pipe Lines (South B.C.) Ltd.

Alberta - B.C. border near Coleman to B.C. - United States border near Kingsgate.

Zone 9 Foothills Pipe Lines (Sask.) Ltd.

Alberta - Saskatchewan border near Empress to Saskatchewan - United States border near Monchy.

Zone 10 Foothills Pipe Lines (North Yukon) Ltd.

Mackenzie Delta Gas fields in the Mackenzie Delta, N.W.T. to a point near the junction of the Klondike and Dempster Highways just west of Dawson, Yukon Territory.

Zone 11 Foothills Pipe Lines
(South Yukon) Ltd.

A point near the junction of the Klondike and Dempster Highways near Dawson to the connecting point with the Pipeline at or near Whitehorse.

1. INTRODUCTION

1.1 The Hearing

On 12 April 1979, by Order No. RH-2-79, the National Energy Board ("N.E.B." or the "Board") ordered that a public hearing be held in Ottawa to hear evidence and submissions on the tariffs and tolls to be charged by Foothills Pipe Lines (Yukon) Ltd. ("Foothills (Yukon)"), the financing of the pipeline and other related matters. The Board decided to hear evidence and submissions on these matters in phases.

Phase I of the Hearing, which was completed on 26 June 1979, dealt with the Board's proposed method for the regulation of the tolls and tariffs of the Foothills (Yukon) pipeline, the form and content of the tariff for the pipeline as a whole in Canada excluding provision for "prebuild" facilities, and the preliminary expenditures incurred up to 31 December 1978 with a view to qualifying them for inclusion in the rate base of Foothills (Yukon) and its subsidiary companies.

On 30 July 1979, the Board released its Reasons for Decision on Phase I and issued Order No. TG-1-79, by which the Board disposed of the above issues.

In Phase II of the Hearing, which was completed on 10 August 1979, the Board considered whether the form and content of the tariff for the movement of Alberta gas through the southern portion of the Canadian segments of the Alaska Highway Gas Pipeline System proposed to be prebuilt (i.e., the "prebuild" section) was appropriate for the determination of just and reasonable tolls for such movement.

On 4 October 1979, the Board released its Reasons for Decision on Phase II and issued Order No. TG-4-79, by which the Board approved the form and content of the Foothills (Yukon) tariff for the prebuild sections subject to certain conditions set out therein.

In Phase III of the Hearing, which was completed on 29 October 1979, the evidence, submissions and argument were divided into three subject areas:

(1) An application by Foothills (Yukon) for Review and Variation of the Phase I Decision,

(2) The Incentive Rate of Return Scheme (IROR), and

(3) Matters Deferred from Phase II.

On 20 December 1979, the Board released its Reasons for Decision on Phase III, by which it disposed of the above issues and drafted Regulations pursuant to Section 36 of the Northern Pipeline Act respecting the Incentive Rate of Return and Related Tariff Matters.

Phase IV

By Order No. AO-4-RH-2-79, the Board amended the subject matter of Phase IV of the Hearing to consider evidence, submissions, and arguments on the following:

(a) the feasibility of financing the "prebuild" facilities in Canada and the United States.

(b) the financing of the whole mainline.

(c) matters raised in the Board's Reasons for Decision on Phase III of the Hearing.

At that time, Phase IV was also to deal with matters relating to establishing to the satisfaction of the Board that the requirements of Condition 12 of Schedule III of the Northern Pipeline Act were met.

Phase IV(a)

Item (a) above was discussed at a hearing commencing on 19 February 1980, pursuant to Order No. PO-5-RH-2-79. It was intended at the time to consider the remaining matters set out above later at Phase IV(b).

On 11 March 1980, the Board delivered from the Bench its Findings on Phase IV(a). The key Findings were as follows:

1. Prebuild facilities are not financeable on the basis of presently approved exports and depreciation rates.

2. The Western Leg of the Foothills (Yukon) pipeline would be financeable with total throughputs of 19 906 500 000 m^3 (701 Bcf) dedicated through firm export licences.

3. The Eastern Leg would be financeable with total throughputs of 57 987 100 000 m^3 (2,046 Bcf) dedicated through firm export licences.

4. Minimum conditions of financeability would appear to require the transfer to the Eastern Leg of 12 747 500 000 m^3 (450 Bcf) from already licensed volumes now dedicated to other pipeline systems.

5. As a minimum condition for financing, certain high rates of depreciation are necessary during the operation of the prebuild facilities, subject to adjustment when Alaska gas begins to flow.

6. The conditional licence applied for by Pan-Alberta to export 9 953 200 000 m^3 (352 Bcf) of gas through the Western Leg from 1988 to 1992 is not required for the financing of the pipeline.

Following the release of the Phase IV(a) Findings, the Board, on 2 April 1980, issued, subject to the approval of the Governor in Council, Order No. NPO-2-80, amending Condition 12 of the Schedule III of the Northern Pipeline Act, to require Foothills (Yukon), inter alia, to establish to the satisfaction of the Minister responsible for the Northern Pipeline Agency and the Board, that financing has been obtained for the "prebuild" facilities and can be obtained for the rest of the mainline in Canada so that construction of the pipeline could be completed by the end of 1985.

By letter dated 2 April 1980, the above-mentioned Minister, the Honourable H.A. (Bud) Olson, advised the Board that it would assist the Government if the Board would initiate a hearing into the financing of the pipeline in Canada. By Order No. GH-4-80, the Board convened a hearing commencing on 29 April 1980, under section 20(3) of the National Energy Board Act, to provide Foothills (Yukon) with an opportunity to comply with the requirements of Condition 12(1), as amended by Order No. NPO-2-80 (the Condition 12 hearing).

Phase IV(b)

Since the subject matter of the Condition 12 hearing rendered redundant much of the proposed material to be discussed in Phase IV(b), a further amendment to the hearing was required. This the Board did by Order No. AO-5-RH-2-79, which confined Phase IV(b) to the following:

- to dispose of tariff matters raised in the Board's Reasons for Decision in Phases I, II, III and IV(a) of the Public Hearing Respecting Tolls and Tariffs to be Charged by Foothills Pipe Lines (Yukon) Ltd., the Financing of the Pipeline, and Other Related Matters,

- to consider the draft regulations in respect of depreciation charges in the tariff on the pre-built facilities of the pipeline, in the zones where applicable ...

- to dispose of any other related matters including the allocation of administrative expenses of Foothills Pipe Lines (Yukon) Ltd., and the determination of the disposition of the preliminary expenditures of Foothills Pipe Lines (Yukon) Ltd. and the sponsor companies during the year ending December 31, 1979, and adjustments to prior years preliminary expenditures.

Then, by Order No. PO-6-RH-2-79, the Board set down Phase IV(b) for public hearing commencing on 5 May 1980.

2. FIVE TARIFF ISSUES

In response to the provision in Board Order AO-5-RH-2-79 for review, during Phase IV(b), of outstanding tariff matters arising from the Board's Reasons for Decision in Phases I, II, III, and IV(a), Foothills (Yukon) requested reconsideration of the tariff issues which are discussed below:

1. Commencement date of payment of full cost of service under the Foothills mainline tariff;

2. Incentive Rate of Return Scheme for mainline facilities;

3. Depreciation rate for Zone 6 of the prebuild phase;

4. Assurance of return on and of debt capital as a result of amortization of deferred account created by a 30-day interruption for both mainline and prebuild tariffs; and

5. Allocation of unallocated gas losses for both mainline and prebuild tariffs.

2.1. Commencement Date of Full Cost of Service Under the Mainline Tariff

The Board, in its Reasons for Decision following Phase I, as amended in the opening statement of Phase III, approved the form and content of the mainline tariff subject to the inclusion, inter alia, of the following:

1. The tariff shall commence

   (a) upon the day when gas first begins to flow; or

   (b) sixty days after the leave to open order has been granted by the Board for the whole of the pipeline in Canada; or

   (c) upon the day of the commencement of the tariff in the United States under F.E.R.C. Order No. 31 and amendments thereto;

   whichever day shall first occur;

2. A minimum bill on a basis similar to that included in F.E.R.C. Order No. 31 shall apply throughout the 12-month period from the start of the tariff unless the revenues generated from the interim rate or the full cost of service, if applicable, will be higher;

3. An interim rate on a basis similar to that contained in F.E.R.C. Order No. 31 in the 12-month period from the date of commencement of the tariff in Canada so long as the interim rate generates more revenue than the minimum bill, and the quantity of gas being shipped is less than the design capacity throughputs as determined by the Board; and

4. During the period from when a leave to open order applies to the whole of the pipeline in Canada until a full cost of service tariff comes into effect, the portion of the full costs of service that will exceed revenues, as provided for in 1, 2, and 3 above, be capitalized and included in rate base (excluding any provision for normalized income tax in relation to return on equity that is to be capitalized as a result of this requirement).

On 28 August 1979, Foothills (Yukon) applied to the NEB pursuant to Section 17 of the National Energy Board Act, for review and variation of the decision of the Board on these matters. This application was the first matter considered when Phase III commenced 23 October 1979.

The Board found that new evidence presented at that time, while amplifying Foothills (Yukon)'s position, did not add any new dimension. The Company continued to insist that, for the financial viability of the project, it was essential that the full cost of service tariff commence on completion to facilitate servicing not only the debt of the Company but also the debt incurred by the sponsors in generating funds for equity investment in the pipeline. The Company had no financing plan to place in evidence at that time, and the Board suggested that if suppliers of debt capital to the project could not tailor their servicing needs to the cash flow of Foothills (Yukon) and its sponsors, then some modification of the sponsors' approach to financial planning might become necessary. At the same time, the Board did recognize the concern of Foothills (Yukon) with regard to who would finance the carrying cost of the investment in the pipeline if it was complete and ready for service but if an extended delay occurred before gas began to flow in the pipeline. While pointing out that the problem would be reduced in magnitude when the southern portions of the line in Canada were prebuilt and in operation, the Board did acknowledge supplementary financing would be required and directed that the subject be addressed along with financing matters in Phase IV.

During the current phase, witnesses for Foothills (Yukon) reiterated the sponsors' stipulation that they would not invest in the project unless Foothills (Yukon) was paid its full cost of service when the pipeline was ready to commence service in Canada. While they were prepared to accept, as an alternative to changing the approved starting date of the tariff, a scheme whereby a credit-worthy party would provide the necessary supplementary financing from date of completion until full cost of service was available under the tariff, no such credit-worthy party was identified.

Although the earlier decision by the Board on the starting date and initial payments under the tariff was partly based on an assumed need for compatibility with the tariff as approved by the F.E.R.C. in Order 31, the reasonableness of the position taken by the Company and the sponsors on financing is of greater concern if the project is to go ahead. Accordingly, in the special circumstances of this case, the Board finds that either tariff - the one providing for payment of full cost of service when the pipeline was ready for service, the other as already approved supplemented by a financing scheme - would be just and reasonable. Therefore, the Board approves the effective date to receive full cost of service under the mainline tariff as the date when leave to open has been granted for the whole of the pipeline in Canada. However, as an alternative, if supplementary financing is arranged to meet the requirements of Foothills (Yukon) from date of final leave to open until full cost of service is received, the approval of the form and content of the tariff in Phase I, as amended in Phase III, is not revoked.

2.2 Incentive Rate of Return Scheme for Mainline Facilities

During Phase III of the current hearing, the Board heard evidence and submissions in order to finalize the Incentive Rate of Return Regulations and facilitate the implementation of the Incentive Rate of Return Scheme referred to in Part II and section 4 of Schedule I of the Northern Pipeline Act. The Regulations as approved were included as Appendix B to the Phase III Reasons for Decision, and, in its Disposition, the Board indicated that an Incentive Rate of Return Scheme was to be instituted in conformity with those Regulations and with the

Reasons for Decision. In its Decision, the Board provided three instances in which the Regulations might be varied, one of which was if:

> "circumstances arise in the future which are unforeseen at this time, but which, in the opinion of the Board, would make a change in the Incentive Rate of Return Scheme desirable."

During Phase IV(a), the Company presented evidence in support of its request that either the IROR scheme be removed for the prebuild facilities, or the scheme for Zones 6 through 9 be altered to a base similar to that approved by the F.E.R.C. for application in the United States. The Board, in its Decision, found that unforeseen circumstances had arisen in respect of the prebuild Zones which made a modification of the scheme for those Zones desirable, and approved the following changes:

> "The scheme for prebuild facilities in these zones will be based on a centre point of 1.0. The final design costs for the prebuild facilities in these zones as approved by the Northern Pipeline Agency, and as accepted by the National Energy Board, expressed in constant dollars, i.e., excluding any provision for inflation, will replace the "Filed Capital Costs" for cost performance measurement purposes, but will be subject to similar adjustments, including the Provision for Funds Used During Construction of 11.7 percent. The final design costs may be modified by scope changes mandated by the Northern Pipeline Agency after construction is underway.
>
> "For purposes of establishing the cost performance ratio, the Actual Capital Costs will be deflated to the constant dollars used in the final design cost estimate by using the GNP price deflator in a manner determined by the Board.
>
> "The IROR Scheme for the incremental facilities in Zones 6, 7, 8, and 9, needed for the throughput of Alaska gas will be on a basis similar to that outlined above."

In Phase IV(b), the Company requested the Board to change the IROR Scheme in respect of Zones 1 to 5 inclusive to parallel the changes already approved for the prebuild facilities. Witnesses for the Company presented Revised Cost of Facilities estimates for the total project of $8,367 million * as compared with the Filed Capital Cost of $4,325

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* This estimate was based on 2.0 Bcf per day of Alaska gas and 1.0 Bcf per day of Alberta gas.

million. During cross-examination, it was established that these latest estimates included the cost of additional facilities to carry Alberta gas which were not certificated under the Northern Pipeline Act, as well as costs which would be eliminated for cost performance measurement purposes, such as NEB and Northern Pipeline Agency monitoring costs, property taxes, and road maintenance in the Yukon. However, review of the Mainline Facilities March 1980 Estimates for Zones 1 to 5, expressed in 1976 dollars for comparison with the Adjusted Filed Capital Costs, did reveal a considerable increase in the cost-performance ratio in some zones, for instance 1.72 in Zone 1. In drawing attention to these figures, a witness for the Company noted that it was virtually impossible to know what part of that increase would be found to be attributable to delays in the United States or other adjustments which may be allowed. Concern was expressed regarding the inability to estimate with any assurance the expected return to be earned on equity investment in northern zones where it is hoped to offer residents in the area a reasonably attractive investment opportunity.

The Board finds that circumstances have arisen in respect of Zones 1 to 5 which were unforeseen at the time of the Phase III Decision and which make a modification of the IROR scheme desirable. Accordingly, the scheme for the pipeline facilities in these zones will be amended on the same basis as for Zones 6 to 9. However, because the IROR Scheme is only applicable to facilities certificated under the Northern Pipeline Act, the Board will require that the Company prepare detailed reconciliations of the facilities and costs covered by the "Filed Capital Costs" and that those contained in the Final Design Costs be approved by the Minister and the Board.

2.3 Depreciation Rate for Zone 6 of the Prebuild Phase

During Phase IV(a), as a minimum condition for financeability, Foothills (Yukon) applied to be allowed to depreciate the original cost of prebuild facilities in Foothills (Alta.) Zone 6 by 50 percent over the term of the firm export licences, which the Board found acceptable. However, in its Decision, the Board stated that it believed that the need for the 50 percent depreciation was conditional on the Board approving

the transfer of the assets of Foothills (Alta.) in Zone 6 to AGTL at the end of the term of the firm licences if Alaska gas does not flow, and, since it was not able to grant such a regulatory ruling, the Board did state it would, upon application, be prepared to consider a depreciation proposal for Zone 6 similar to that approved for Zone 7, namely a 100 percent write-off over the term of the firm export licences.

In the current Phase, the Company acknowledged that the "buy-back" had been required in conjunction with the 50 percent write-off to insure recovery of the debt by the lenders, and, in the absence of Board approval of the proposal, they applied to change the rate of depreciation from 50 percent to 100 percent over the term of the Pan-Alberta gas export licence. The Board approves this request.

2.4. Assurance of Return On and Of Debt Capital Following a 30-Day Interruption

In its Phase I Decision, the Board ruled that if an outage of more than 30 days occurred in the operating phase of the pipeline, either mainline or prebuild, the Board would initiate an enquiry into the cause of the failure to provide service. The Decision implied that if Foothills (Yukon) were responsible for the cause of the outage, then Foothills (Yukon) would lose its return of equity. During Phase III, the Company applied for review of this ruling on two grounds: first, that it should only lose its return of equity if negligence could be proven and, second, that it required assurance that there would be enough cash for the servicing of debt in all circumstances. The Board, in its Decision, accepted the concept that Foothills (Yukon) should lose its return of equity only in those circumstances where it was responsible for the cause of the outage, but saw no reason to change the wording of the clause to be inserted in the tariff, as the concept of fault was implicit therein. Nor did the Board see any reason to change the wording of the clause to provide that there would be enough cash for the servicing of debt in all circumstances, pointing out instead that prudent management of cash resources could alleviate the potential problems arising from the need to meet large debt repayments during or immediately after a prolonged service interruption. The Board assured the Company that it would always have the right to seek relief in special circumstances.

This second issue was raised again in the current Phase, as Foothills (Yukon) continued to seek assurance from the Board that under no circumstances should there be an erosion of its ability to meet ordinary debt-service requirements. To achieve this end, the company introduced a slightly different wording for subparagraph 9.62 of Rate Schedule T-1 of the Prebuild Tariff from that provided by the Board in its Phase I Decision. The Board has found this wording acceptable for inclusion in the tariff subject to the following minor amendment. The Company had referred to a "deferred depreciation account"; the Board requires that the phrase be changed to read "deferred revenue account".

2.5 Allocation of Lost and Otherwise Unaccounted for Gas On a System Basis

Foothills (Yukon) proposed a change to the gas transportation tariff whereby Lost and Otherwise Unaccounted for Gas would be determined on a total-system basis and then allocated to individual zones rather than measuring the losses in each zone. This change would remove the need for non-custody transfer mainline meter stations between zones. All gas received and delivered by the company as well as gas used by the company for compressor fuel and operations would continue to be metered and accounted for at receipt points, delivery points and compressor stations.

Foothills (Yukon) proposed to allocate the total-system gas losses to individual zones on the basis of "Accountable Losses". An alternative term used in the General Terms and Conditions, section 7.72, of the filed subsidiary tariffs was "Accountable Gas". Neither of these terms was defined. Evidence adduced during the Hearing indicated that the intention was to allocate gas losses based on system use as indicated by the quantity of gas used for compressor fuel and other pipeline operating requirements in each zone.

The Board feels that an allocation scheme based on the quantity of gas used for company operations might be subject to a number of factors which could cause inequitable allocation of gas losses among zones and between the Eastern and Western Legs of the system. The allocation scheme could, therefore, cause inequitable allocation of gas losses to parties affected, namely, shippers, consumers, and Alberta producers.

The Board's approval of the allocation of Lost and Otherwise Unaccounted for Gas on a system basis is, therefore, subject to the Foothills Subsidiary Tariffs being modified by the substitution of the following text for section 7.7 of the General Terms and Conditions of the Subsidiary Tariffs.

"7.7. Allocation

> The total number of joules of Lost and Otherwise Unaccounted for Gas in Shipper's total transportation system shall be allocated to a Company Zone by multiplying the total number of joules of Lost and Otherwise Unaccounted for Gas determined for the total Foothills Pipe Line (Yukon) Ltd. system by a fraction, the numerator of which shall be the product of Daily Receipt Quantities applicable to the Zone and the distances in kilometres such quantities are transported through the Zone, and the denominator of which shall be the sum of such products for all Zones."

3. REGULATIONS IN RESPECT OF AN EXCESS DEPRECIATION CHARGE IN THE TARIFF ON THE PREBUILD FACILITIES OF THE PIPELINE

In its findings following Phase IV(a), the Board stated that the rate of depreciation in prebuild facilities in Zones 6, 7, 8, and 9, would require adjustment when Alaska Gas flows. It went on to explain:

> "The manner of making the adjustment and the determination of what the rate of depreciation should be at that time depends on the way the export price of natural gas will be established."

In Order No. AO-5-RH-2-79 the Board amended the description of the subject matter of this Phase to include the following:

> "(j) to consider the draft regulations in respect of depreciation charges in the tariff on the pre-built facilities of the pipeline, in the zones where applicable, which regulations are attached to this Order as Appendix 1,".

The regulations so referred to were developed by the Board in order to implement a proposal whereby producers in Alberta of natural gas transmitted through the prebuilt facilities would be compensated, when Alaska gas flowed, for having been required to absorb the net effect of depreciation charges on the prebuilt facilities in excess of four percent.

In his opening statement at the commencement of this Phase, the Chairman provided some details on the Zones to which these regulations may apply:

> "Therefore, with respect to the Foothills (Yukon) system, it would appear that if the present practice continues, the cost of transportation in Zones 8 in B.C. and 9 in Saskatchewan will be incorporated in the export price, whereas the cost of transportation in Zones 6 and 7 in Alberta would be deducted from the netback at the Alberta border in flowing back the funds to the Alberta Petroleum Marketing Commission under the Petroleum Administration Act. Therefore, it would appear that if present practices continue, Zones 6 and 7 would be covered by the new regulations if and when they are to be implemented."

In presenting these draft regulations for examination, the Board invited Foothills (Yukon) and/or the intervenors to identify modifications which they felt were necessary. No such modifications having been requested, the Board will seek Governor-in-Council approval of these regulations. In respect of the Company's query regarding the memorandum account, the Board will issue a statement of clarification at a later date.

4. ALLOCATION OF ADMINISTRATIVE AND OTHER EXPENSES INCURRED BY FOOTHILLS (YUKON)

During Phase I and Phase II, Foothills (Yukon)'s administrative charge to be allocated to each subsidiary company zone under the cost of service tariff, both prebuild and mainline, was discussed in detail. It was established that such charges would cover the administration of the tariff, including the preparation of budgets and forecasts, and the processing of billings and payments. However, it was also established that, during the period from 1 January 1979 until construction of the mainline is complete, Foothills (Yukon) would be incurring additional expenses that would be capitalized.

Because of its concern that there be a clear segregation of costs between construction and operation of the prebuild facilities and the construction of the mainline, the Board sought to establish during Phase III a clear understanding of what the functional responsibilities of Foothills (Yukon) would be during the whole of the period from 1 January 1979 to completion of the mainline, the nature of the costs being incurred, and the bases and method of allocation between projects and zones proposed by Foothills (Yukon).

At that time it was established that, in addition to the administration of the prebuild tariff, Foothills (Yukon) would be incurring costs related to its overall responsibility for coordinating and monitoring the entire project, securing financing, liaising with the Northern Pipeline Agency and the National Energy Board, and providing specific services for its subsidiary companies, such as major materials procurement. The methods of allocation proposed at that time for indirect charges, based on project budgets, appeared to be loaded towards those zones in which construction was taking place - prebuild initially and mainline later - and ignore the Board's earlier suggestion that monitoring costs from the Northern Pipeline Agency and the National Energy Board be allocated to zones on the basis of "filed capital costs". Since Foothills (Yukon) admitted that its accounting systems and its method of allocation had not been finalized and that a definitive ruling on the matter was not critical to the financing of the project, the Board directed that further consideration would be given to

the subject when Foothills (Yukon) next appeared before the Board for approval of items for inclusion in rate base, i.e., in the current Phase.

Evidence presented during this Phase appeared to indicate that Foothills (Yukon) was proposing a new method for allocation of its indirect expenses between zones and between mainline and prebuild. However, examination by counsel for the Canadian Petroleum Association revealed that the change was merely a replacement of the former project budget base with a method of allocation in proportion to direct expenses as incurred. This did not overcome the loading problem identified earlier, for, though it recognizes the activity directly chargeable to the individual zones and between prebuild and mainline, it assumes that all other expenditures are incurred in the same proportion as directly charged activities. Foothills (Yukon) did not demonstrate the reasonableness of this method of allocation to the satisfaction of the Board. Therefore, the Board approves the method of allocating the administrative expenses of Foothills (Yukon) on an interim basis only, subject, as noted in Chapter 5, to review at a later date.

5. PRELIMINARY EXPENDITURES

Foothills (Yukon) applied to include 1979 expenditures of $47,407,000 in its rate base and/or the rate base of its subsidiaries. A summary of the 1979 expenditures, showing the Applicants's allocation of the expenditures to subsidiaries and between "prebuild" and mainline follows:

	Total Expenditures ($000)	Prebuild ($000)	Mainline ($000)
Foothills (Yukon)	22,023	10,493	11,530
Foothills (South Yukon)	5,239	—	5,239
Foothills (North B.C.)	1,737	—	1,737
Foothills (Alta.)	6,207	5,807	400
Foothills (South B.C.)	478	478	—
Foothills (Sask.)	675	546	129
Foothills (North Yukon)	1,351	—	1,351
AGTL	*5,882	539	5,283
Westcoast	*3,598	525	3,073
ANG	* 277	10	267
	47,407	18,398	29,009

* AFUDC only. Amount allocated to prebuild represents a portion of AFUDC on 1979 expenditures only.

Only Foothills (Yukon) led evidence on this part of the proceeding, and no intervenor opposed the inclusion of these expenditures in rate base. However, CPA questioned the methods used in allocating the expenditures between the prebuild and mainline projects. Subject to the following observations, the Board approves the 1979 preliminary expenditures of $47,407,000 for inclusion in the rate base of Foothills (Yukon) and/or its subsidiary companies.

Northern Alberta Burst Test Facilities (Rainbow Lake)

Included in the 1979 expenditures was some $7,744,000 for the construction of a burst test facility at Rainbow Lake in Northern Alberta and test operating costs (1978 Expenditures of some $840,144).

During cross-examination it was stated that the Company will continue to operate the facility and to offer commercial services to third parties after it completes its current series of tests.

The Board is not satisfied with the evidence given in respect of these burst test facilities and grants provisional approval only. In the interim, the Company will retain the 1979 costs in the rate base of Foothills (Yukon), and the Board will expect the Company to provide further evidence on capital costs of the facilities, operating costs of the facilities, recovery of operating costs, and a justification of why this facility should be included in rate base as part of the pipeline rather than being classified under account 110, Other Plant, as defined in the NEB "Gas Pipeline Uniform Accounting Regulations".

Allowance for Funds Used to Finance Preliminary Expenditures (AFUDC)

The sponsor companies claimed the amounts of AFUDC included on the last three lines of the Summary of 1979 Expenditures shown above. The Board has reviewed the calculations and finds the amounts to be reasonable.

The Board therefore approves the amounts shown for each sponsor, totalling $9,697,000, as an allowance for funds used to finance the preliminary expenditures and authorizes its inclusion in rate base when the amounts for each sponsor company have been transferred to the books of the Foothills (Yukon) companies. In addition, the Board directs that the portion of the allowance pertaining to 1978 and prior-year expenditures, including the compounding effect, be held in the rate base of Foothills (Yukon).

Other Matters

During cross-examination, the Applicant indicated that if the prebuild proceeds on schedule in 1980, the Agency Agreement between Foothills (Yukon) and its sponsors would have to be altered or terminated to permit the recording of the expenditures on prebuild in the books of the subsidiary companies. Foothills (Yukon) is hereby required to notify the Board when the Agency Agreement is

amended or terminated and to specify and illustrate how the amounts approved to that date by the Board for inclusion in rate base of Foothills (Yukon) or its subsidiaries are to be transferred from sponsors, affiliates, or Foothills (Yukon) Agency Accounts to the plant account of Foothills (Yukon) and its subsidiaries.

A witness for the Applicant indicated that the sponsors will be claiming their respective share of the 1979 expenditures for income tax purposes. In its Reason for Decision on Phase I of this proceeding, at page 49, the Board ruled on the impact on the toll of the tax aspect of the preliminary expenditures of 1978 and prior years as follows:

> "Accordingly, the Board finds that it is just and reasonable that the tolls of Foothills (Yukon) should be no higher than they would have been had the pre-construction expenses, approved by the Board, been eligible for deduction for tax purposes against the income tax of Foothills (Yukon). Accordingly, the Board will require that normalized taxes included in the cost of service of Foothills (Yukon) will be computed on the basis that Foothills (Yukon) could deduct the expenses for tax purposes."

The Board finds that its previous ruling on the tax aspects of the 1978 and prior-year expenditures also pertains to the 1979 expenditures.

The preliminary expenditures for 1979 included charges from the Northern Pipeline Agency of $4,704,000 and from the National Energy Board of $118,000. These charges, under Section 46.1 of the National Energy Board Act, are subject to audit by the Auditor General of Canada. When the Auditor General has certified that the expenses giving rise to those charges were incurred for the purposes stated in the Act, Foothills (Yukon) is authorized to include them in its rate base and/or the rate bases of its subsidiaries.

Reduction of 1978 and Prior-Years Expenditures

The Board approved preliminary expenditures of $79,111,000 for inclusion in the rate base of Foothills (Yukon) in its decision on Phase I of this hearing. In the current phase, Foothills (Yukon) requested a net reduction of $145,000 from the preliminary expenditures previously approved.

The reduction consists of a depreciation and amortization reversal of $460,000 less AFUDC adjustments of $180,000 and other minor adjustments of $135,000.

The Board notes that no intervenor opposed the reduction, and the Board approves the reduction of $145,000 to the rate base of Foothills (Yukon).

6. GAS TRANSPORTATION TARIFF PHASE I APRIL 1980 - PREBUILD TARIFF

The Prebuild Gas Transportation Tariff, April 1980, which was examined during this Phase was found to contain the full complement of service agreements required for the operation of the tariff, including the agreements between Foothills (Yukon) and the shippers, Pan-Alberta and TransCanada, and the agreements between Foothills (Yukon) and its subsidiaries, Foothills (Alta.), Foothills (South B.C.) and Foothills (Sask.). Also included were operating agreements between the Foothills (Yukon) subsidiaries and the local operators, AGTL, ANG, and TransCanada, respectively, and the Gas Transportation Agreement between Foothills (South B.C.) and ANG. All of these agreements had been duly executed except for the operating agreement between Foothills (Sask.) and TransCanada.

During cross-examination, it was established that, apart from the service agreement between Foothills (Yukon) and TransCanada and the subsidiary service agreement between Foothills (Yukon) and Foothills (Sask.), all of the agreements contained in the tariff were similar to those previously approved by the Board during Phase II. The content of the service agreements pertaining to TransCanada's use of the facilities of Foothills (Sask.) (Zone 9) were found to be substantially in agreement with the throughput obligations of TransCanada as established in Phase IV(a), but detailed examination of the provision for abatement of depreciation as contained in the subsidiary tariff was deferred for consideration in a later rate case.

With the exception of the items already discussed in these Reasons for Decision and the wording changes to make the tariff a multiple-shipper document as agreed to in Phase II, the remainder of the tariff, composed of the rate schedules and general terms and conditions, was found to be in accordance with the prebuild tariff as approved by the Board in earlier phases. Therefore, subject to the required changes as already identified in these Reasons for Decision and the execution of the operating agreement between Foothills (Sask.) and TransCanada, the Prebuild Gas Transportation Tariff is found acceptable to the Board.

DECISION ON PHASE IV(b) OF TARIFF AND FINANCING HEARING

Phase IV(b) was the final phase of the Hearing called by the National Energy Board under Order No. RH-2-79 for consideration of the tariffs and tolls to be charged by Foothills Pipe Lines (Yukon) Ltd. ("Foothills (Yukon)"), the financing of the pipeline and other related matters. This final phase dealt with the five tariff matters requested by Foothills (Yukon), the consideration of draft regulations relating to excess depreciation in certain zones in the prebuild period, the allocation of the administrative expense of Foothills (Yukon), the approval for rate base purposes of preliminary expenses for 1979, and the approval of the "prebuild" tariff.

Turning first to the five tariff issues raised by Foothills (Yukon):

1. Foothills (Yukon) stated categorically throughout this and previous phases of the Hearing that its sponsors would not commit equity to the project and that Foothills (Yukon) would not build the pipeline unless it was paid in full for its services under the mainline tariff when it had been granted "leave to open" for the pipeline in Canada. Two means of achieving this were identified: first, by having a tariff which provided for payment of the full cost of service when the pipeline was ready for service and, second, by using the tariff as already approved, supplemented by a financing scheme. In the special circumstances of this case, the Board finds that either tariff would be just and reasonable. Therefore, the proposal of Foothills (Yukon) to receive full payment of the cost-of-service tariff for the mainline when leave to open has been granted for the whole of the pipeline in Canada is hereby approved. As an alternative, if supplementary financing is arranged to meet the requirements of Foothills (Yukon) that it be paid in full when able to provide service, the Board's approval in principle of the previous Foothills (Yukon)'s tariff containing a 60-day delay, minimum bill and interim rate is left unchanged.

2. In Phase IV(a) the Board approved an Incentive Rate of Return Scheme for prebuild facilities based on a centre point of 1.0 for the cost performance ratio used in relation to final design costs. The Board hereby approves the IROR Scheme for the remainder of the pipeline facilities on the same basis. Final design costs will have to be justified to the Board by comparing them with "the filed capital costs" in the Canada/U.S. Agreement and explaining changes to the satisfaction of the Board.
3. In Phase IV(a), the Board approved a depreciation rate for Foothills (Alta.) Zone 7 and Foothills (South B.C.) based on a 100 percent write-off of the assets over the life of the firm licences and contemplated using the same basis for the depreciation rate for Foothills (Alta.) Zone 6. The Board, having heard the application of Foothills (Yukon), hereby approves the same basis of depreciation for Zone 6.
4. With respect to the billing adjustment for an interruption of service in excess of 30 days, the Board approves the wording contained in subparagraph 9.62 of Rate Schedule T-1 of the Prebuild Tariff submitted by Foothills (Yukon), subject to an amendment of the term "deferred depreciation account" to "deferred revenue account".
5. The Board approves the request of Foothills (Yukon) that:

   "The prebuild and mainline tariffs should be amended to provide that the allocation of unallocated gas losses will be made on a system basis and not on a subsidiary basis"

On other matters:

1. In examination of the draft "Regulations in Respect of an Excess Depreciation Charge in the Tariff on the Prebuilt Facilities of the Pipeline", no modifications were requested by any party. The Board has, therefore, decided to seek Governor in Council approval of the Regulations. Under the present pricing regime they will apply in Zones 6 and 7 in Alberta.

2. Foothills (Yukon) did not fully demonstrate to the satisfaction of the Board the reasonableness of its method of allocating the administrative and other expenses recorded in 1979 between its subsidiaries and between prebuild and mainline facilities.

   The Board finds that any allocation to the prebuild facilities of AFUDC in respect of 1978 and prior-year expenditures and also of the cost related to the Burst Test Facility is inappropriate and should remain in the rate base of Foothills (Yukon). Because of the foregoing, the Board approves the method of allocating the administrative expenses of Foothills (Yukon) on an interim basis only, subject to review at a later date.

3. The Board approves for inclusion in the rate base preliminary expenses for 1979 of $47,407,000 and a reduction of $145,000 in the amount previously approved for prior periods. The inclusion therein of all of the costs of the Northern Alberta Burst Test site is provisional only and will be the subject of further review by the Board. In addition, the approval of the expenses of the Northern Pipeline Agency and the National Energy Board is conditional upon the Board receiving the appropriate certificate from the Auditor General of Canada.

4. The Prebuild Tariff submitted by Foothills (Yukon) in the Phase IV(b) proceeding is hereby approved, subject to the changes required by this Decision and the execution of the Operating agreement between Foothills (Sask.) and TransCanada.

The foregoing sets forth the Board's Decision in this matter.

C.G. Edge
Presiding Member

L.M. Thur
Member

R.B. Horner
Member